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No. 77-410

In the Supreme Court of the United States

OCTOBER TERM, 1977

CITY OF PHILADELPHIA, ET AL., APPELLANTS

v.

SECURITIES AND EXCHANGE COMMISSION, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

MOTION TO DISMISS OR AFFIRM

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OPINION BELOW

The opinion of the district court (J.S. App. A1-A14) is reported at 434 F. Supp. 281.

JURISDICTION

The judgment of the district court (J.S. App. A15-A16) was entered on May 20, 1977. The notice of appeal (J.S. App. A31-A32) was filed on July 18, 1977.[1] The appeal was docketed on September 15, 1977. The jurisdiction of this Court is invoked under 28 U.S.C. 1253. For the reasons discussed at pages 5-8, *infra,* we submit that the Court should dismiss the appeal for want of jurisdiction.

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[1]Appellants also have filed a notice of appeal to the court of appeals, which has stayed proceedings pending the outcome of this appeal (J.S. 3 n. 1).

QUESTIONS PRESENTED

1. Whether this Court has jurisdiction of the appeal in this case.

2. Whether the district court properly held that appellants' challenges to the constitutionality of certain provisions of the federal securities laws were not ripe for decision.

3. Whether an informal inquiry by the staff of the Securities and Exchange Commission into the offer and sale of securities of the City of Philadelphia is an unconstitutional intrusion on state sovereignty.

STATEMENT

States and political subdivisions are exempt from most of the provisions of the federal securities acts. They need not, for example, register their offerings of securities or file with the Securities and Exchange Commission copies of any prospectus they may choose to publish.[2] Political bodies, like everyone else, may not, however, distribute their securities by fraudulent means, and they are exposed to civil and criminal penalties if they should commit fraud

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[2]See Section 15B(d)(1) of the Securities Exchange Act of 1934, as added by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 137, 15 U.S.C. (Supp. V) 78*o*-4(d)(1). States and their subdivisions are included in the class of "persons" subject to the statutes only for limited purposes, and the limitations preclude application of the registration and certain disclosure requirements. See Section 2(2) of the Securities Act of 1933, 48 Stat. 74, 15 U.S.C. 77b(2) (defining governments as "persons"); Section 3(a)(2) of the same statute, as amended, 15 U.S.C. 77c(a)(2) (exempting governmental securities from most provisions of the statute); Section 3(a)(9) of the Securities Exchange Act of 1934, as amended, 89 Stat. 97, 15 U.S.C. (Supp. V) 78c(a)(9) (governmental bodies are "persons"); Section 3(a)(12) of the same statute, as amended, 89 Stat. 97, 15 U.S.C. (Supp. V) 78c(a)(12) (securities issued by governments are exempt from most substantive provisions of the statute).

in the sale of their securities.[3] Moreover, the Commission may require political bodies to furnish information in order to determine whether they are complying with the applicable substantive provisions of the statutes, or whether third parties are complying with the laws, or to determine whether changes should be proposed in the Commission's statutes or rules.[4]

Although the Commission thus possesses the authority to conduct investigations using compulsory process, it has established by regulation a preliminary procedure that is designed to determine whether a compulsory investigation should be conducted. 17 C.F.R. 202.5. A preliminary inquiry relies on the voluntary cooperation of persons in whose conduct the Commission is interested. It cannot involve resort to any of the Commission's statutory powers of compulsion, and, if the subjects of the inquiry decline to cooperate, the Commission may either close the investigation or authorize a formal investigation during which it would be able to make use of compulsory process.

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[3]See note 2, *supra*. The anti-fraud provisions applicable to governments are Section 17(a) of the Securities Act of 1933, 48 Stat. 84, as amended, 15 U.S.C. 77q(a), and Section 10(b) of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. 78j(b). The civil injunctive provisions applicable to governments are Section 20(c) of the Securities Act of 1933, 48 Stat. 899, as amended, 15 U.S.C. 77t(c), and Sections 21(d) and (e) of the Securities Exchange Act of 1934, as amended, 89 Stat. 154-155, 15 U.S.C. (Supp. V) 78u(d) and (e). The criminal provisions applicable to governments are Section 24 of the Securities Act of 1933, 48 Stat. 87, 15 U.S.C. 77x, and Section 32(a) of the Securities Exchange Act of 1934, 48 Stat. 904, as amended, 15 U.S.C. 78ff(a).

[4]Investigations assisted by compulsory process are authorized by Sections 19(b) and 20(a) of the Securities Act of 1933, 48 Stat. 85-86, 15 U.S.C. 77s(b) and 77t(a), and by Section 21(a) of the Securities Exchange Act of 1934, as amended, 89 Stat. 154, 15 U.S.C. (Supp. V) 78u(a).

In May 1976 the Philadelphia Branch Office of the Commission began a preliminary inquiry into the offer, sale, and resale of securities of the City of Philadelphia. The Branch Office requested the City voluntarily to supply certain documents that might bear on the inquiry. The City declined and, on July 29, 1976, brought this suit seeking an injunction against the informal staff inquiry and any formal proceedings the Commission itself might desire to commence.[5] A three-judge district court was convened.[6] Appellants contended that the pendency of the preliminary inquiry adversely affected the market for the City's securities and violated the City's rights under the Fifth and Tenth Amendments to the Constitution (J.S. App. A2-A3).

The district court dismissed the action. It concluded that appellants' challenge to the substantive requirements of the federal securities statutes and to a formal investigation (making use of compulsory process) was premature (J.S. App. A9). The court pointed out that "it is wholly speculative whether the SEC will ever order that a formal investigation be undertaken into the offer, sale, and resale of City securities. As to the constitutionality of the substantive provisions of the securities laws, the City has not alleged that it is considering acting in a way which may be contrary to the prohibitions of the securities laws

[5]The City and its Director of Finance purported to represent a class of all political subdivisions of the Commonwealth of Pennsylvania. The Commission objected to maintaining this suit as a class action, and the district court did not rule on the propriety of the class allegation (J.S. App. A7).

[6]Because the suit was commenced before August 12, 1976, the provisions of Pub. L. 94-381, 90 Stat. 1119, which repealed 28 U.S.C. (1970 ed.) 2281 and 2282, do not apply, and the question whether a three-judge court was necessary therefore was determined under the former statute.

or regulations. * * * Moreover, the SEC has, at this point, made neither formal nor informal efforts to secure the City's compliance with the substantive provisions of the Acts, and it is wholly speculative whether it will do so in the future. * * * These issues are therefore not ripe" (*ibid.*).

The court also held (J.S. App. A9-A13) that appellants' challenge to the constitutionality of the preliminary inquiry was insubstantial. Although it recognized that, under *National League of Cities* v. *Usery*, 426 U.S. 833, Congress may not order States to take specific actions in certain areas of traditional governmental functions, it concluded that there can be no constitutional problem unless the federal government attempts to direct the particulars of state decisions. Here, the court held, the "threshold requirement that the federal action *command* the City is lacking: the City has not been ordered to adopt any measure as to the financing and distribution of its services" (J.S. App. A12, emphasis in original). The court finally rejected appellants' argument, based on the Fifth Amendment, that the statutes and regulations authorizing the preliminary inquiry were unconstitutionally vague (*id.* at A13-A14).[7]

ARGUMENT

1. The appeal should be dismissed for want of jurisdiction. Although appellants' complaint sought an injunction against the substantive provisions of the securities laws to the extent they applied to municipalities, and against the compulsory investigative powers of the Securities and Exchange Commission, the district court did not reach the merits of these contentions. It decided,

[7]Appellants appear to have abandoned the vagueness argument.

instead, that they are not ripe for decision. Although the court did hold that the Commission's preliminary inquiry was not unconstitutional, this decision does not implicate any of the statutes that appellants attack. Their appeal therefore should be pursued in the court of appeals.

a. Because the district court did not address the issues requiring consideration by a three-judge court, direct appeal does not lie to this Court. *MTM, Inc.* v. *Baxley,* 420 U.S. 799; *Gonzalez* v. *Automatic Employees Credit Union,* 419 U.S. 90. *MTM* held that this Court has no jurisdiction of a direct appeal from an order of a three-judge district court dismissing a case on federalism grounds, stating (420 U.S. at 804):

> [W]e conclude that a direct appeal will lie to this Court under § 1253 from the order of a three-judge federal court denying interlocutory or permanent injunctive relief only where such order rests upon resolution of the merits of the constitutional claim presented below.

Similarly, *Gonzalez* held that a dismissal for lack of standing should be appealed to the court of appeals rather than to this Court.

The same principle applies here. The dismissal of the action as unripe for resolution did not "rest[] upon resolution of the merits of the constitutional claim[s] presented" by appellants. In another case in which a three-judge district court dismissed a suit as unripe, this Court held that any appeal must be taken to the court of appeals. *Osceola* v. *Kuykendall,* No. 77-18, appeal dismissed for want of jurisdiction, October 31, 1977. *Osceola* controls this case.

b. The court of appeals did not dismiss the entire suit as unripe; it reached the merits of the challenge to the preliminary inquiry. But an appeal does not lie from this portion of the court's decision because 28 U.S.C. 1253, which authorizes direct appeals, permits such appeals only from judgments for which a three-judge court was required. Former 28 U.S.C. 2282 required a three-judge district court only when an "interlocutory or permanent injunction [is sought] restraining the enforcement, operation or execution of any Act of Congress for repugnance to the Constitution of the United States * * *." Appellants' challenge to the preliminary inquiry, however, does not implicate the constitutionality of any statute. The Commission's preliminary inquiry did not amount to action under a statute; it was, instead, part of the process of considering whether to take action authorized by statute.

The statutes appellants attack authorize an investigation with compulsory process, but no such investigation was under way here; they authorize sanctions to be imposed for violations of the anti-fraud requirements, but there has been no finding of violation and no proposal to impose sanctions. Every challenge to every identified statute was dismissed by the court of appeals as unripe, and, for the reasons already discussed, that decision is not reviewable on direct appeal. What was left—the resolution of the challenge to the preliminary inquiry—did not call any statute into question, and therefore did not

require a three-judge district court.[8] The appeal from the district court's decision therefore should be taken to the court of appeals.[9]

2. If the Court concludes that it has jurisdiction, then it should affirm the judgment of the district court.

a. The district court held that the challenge to the substantive provisions of the securities laws, and to the Commission's investigative powers, is unripe because none of those provisions has been applied to appellants, because appellants do not contend that they desire to violate any of the provisions, and because there is no imminent prospect of their enforcement against appellants (J.S. App. A9). This decision is correct.

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[8]The challenge to the preliminary inquiry might be thought to call into question the statutes defining governmental bodies as "persons" subject to investigation, but it would not necessarily do so. The Commission's power of *preliminary* inquiry is not limited by statute to "persons." Moreover, the Commission may investigate and make reports looking toward legislation rather than enforcement. See Section 21(a) of the Securities Exchange Act of 1934, as amended, 89 Stat. 154, 15 U.S.C. (Supp. V) 78u(a). See also page 14, *infra*. Investigations of this sort do not depend on the definition of "person" or the constitutionality of any substantive provision of the securities laws, although the constitutional questions may have something in common (see J.S. App. A9 n. 3).

[9]*Flast* v. *Cohen*, 392 U.S. 83, 89-91, and *Zemel* v. *Rusk*, 381 U.S. 1, hold that a three-judge court is necessary to consider challenges to the administration of statutes alleged to be unconstitutional. A three-judge court therefore would have been necessary to pass on a request for an injunction against the Commission's use of its compulsory investigative powers. But in both *Flast* and *Zemel* the plaintiffs attacked an identified statute. No identified statute pertains to the Commission's preliminary inquiry, however, and a challenge to the Commission's practices is not, by itself, enough to require the convening of a three-judge court. See *Morales* v. *Turman*, 430 U.S. 322.

There was no reason for the district court to pass on the constitutionality of the statutory scheme in advance of its application to any member of the purported class. "Determination of the scope and constitutionality of legislation in advance of its immediate adverse effect in the context of a concrete case involves too remote and abstract an inquiry for the proper exercise of the judicial function." *International Longshoremen's Union* v. *Boyd*, 347 U.S. 222, 224, citations omitted; see also *Toilet Goods Association* v. *Gardner*, 387 U.S. 158, 166.

"[R]ipeness is peculiarly a question of timing" (*Regional Rail Reorganization Act Cases*, 419 U.S. 102, 140). See also *Buckley* v. *Valeo*, 424 U.S. 1, 113-118. A case is not ripe in the absence of some threat to enforce the statutes in question (*Steffel* v. *Thompson*, 415 U.S. 452, 459), and that threat could come about only if the plaintiff were to allege that it contemplated violating the statute. But appellants do not state that they plan to engage in securities fraud, and so, under their own argument, there would be no basis for enforcement of the statutes against them. Appellants will have a full opportunity to litigate the questions they now raise when, if ever, the Commission seeks to apply the securities laws to them.[10]

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[10]Because the district court dismissed the action as unripe for decision, there would be no occasion for this Court to consider the constitutional arguments appellants present against the application of the substantive provisions of the securities laws to appellants. No court has yet passed on the questions involved, although they have evoked substantial scholarly commentary. See, *e.g.*, Note, *Federal Regulation of Municipal Securities: Disclosure Requirements and Dual Sovereignty*, 86 Yale L.J. 919 (1977); Doty & Petersen, *The Federal Securities Laws and Transactions in Municipal Securities*, 71 Nw. U. L. Rev. 283 (1976); Comment, *Federal Regulation of*

b. We now assume *arguendo* both that appellants are entitled to challenge the preliminary inquiry without exhausting their administrative remedies[11] and that any substantive regulation of the terms of securities offerings by the City would be unconstitutional.[12] Even on these

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Municipal Securities: A Constitutional and Statutory Analysis, 1976 Duke L.J. 1261; Note, *Federal Regulation of Municipal Securities*, 60 Minn. L. Rev. 576 (1976); Note, *Disclosure by Issuers of Muncipal Securities: An Analysis of Recent Proposals and a Suggested Approach*, 29 Vand. L. Rev. 1017 (1976); Note, *Municipal Bonds and the Federal Securities Laws: The Results of Forty Years of Indirect Regulation*, 28 Vand. L. Rev. 561 (1975); Note, *The Constitutionality of the Federal Regulation of Municipal Securities Issuers: Applying the Test of National League of Cities* v. *Usery*, 51 N.Y. U. L. Rev. 982 (1976). Cf. Tribe, *Intergovernmental Immunities in Litigation, Taxation and Regulation: Separation of Powers Issues in Controversies About Federalism*, 89 Harv. L. Rev. 682 (1976).

[11]The district court held that "[a]dministrative remedies need not be exhausted when the constitutionality of the agency action is in question" (J.S. App. A8). Although this Court need not reach that question here, we believe that the district court is incorrect. In a similar case, in which subjects of regulation challenged a preliminary inquiry to determine whether a statute, alleged to be unconstitutional, had been violated, this Court summarily reversed a judgment of unconstitutionality, "the appellee having failed to exhaust its administrative remedy" (*Franklin* v. *Jonco Aircraft Corp.*, 346 U.S. 868). See also *Boire* v. *Greyhound Corp.*, 376 U.S. 473, 476-479; *Allen* v. *Grand Central Aircraft Co.*, 347 U.S. 535, 539-540. We do not pursue the matter here, however.

[12]We believe that nothing in the Constitution precludes application of the anti-fraud provisions of the securities laws to all issuers of securities, including governmental bodies. Congress has the power to regulate not only interstate commerce but also the use of the mails, and governmental bodies may no more use the mails to distribute fraudulent representations than they may use them to raise funds by distributing pornography. It is difficult to understand how making misleading statements or having material omissions in solicitations to purchase securities can be thought to be an essential attribute of state

assumptions, however, the district court correctly decided that nothing in the Commission's preliminary inquiry violated any provision of the Constitution.

The preliminary inquiry that the district court declined to enjoin involved only an informal request by staff members that the City provide certain information. The City was not required to comply and, indeed, did not do so. The injunction therefore could have had only two effects: first, to require the staff not to ask third parties for information about the City's securities, and, second, to require the staff to stop thinking about the City's securities or discussing them in private. The Constitution, however, does not place limits on what information an administrative agency may seek to acquire from willing sources or on internal discussions of agency staff.

National League of Cities v. *Usery*, 426 U.S. 833, on which appellants rely, held that Congress could not "wield its power in a fashion that would impair the States'

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sovereignty or a function " 'essential to separate and independent existence' " of the States (*National League of Cities* v. *Usery*, 426 U.S. 833, 845).

Appellants have not contended that they desire to practice securities fraud or that municipal operations will be hindered in some way unless fraud or deceit is permitted. They therefore have not established the foundation for an argument based on *National League*: the "forced relinquishment of important governmental activities" (426 U.S. at 847). Although appellants argue that any regulation of the securities markets will interfere with their ability to raise money for governmental operations, it could as easily be argued that the application of the anti-fraud provisions of the securities acts will make investors more likely to believe statements by municipal securities issuers, and hence more likely to invest in municipal securities as opposed to already-regulated private securities. But however that may be, for the reasons stated in the text appellants' claim fails even if it is assumed that the Constitution places some restrictions on regulation of municipal securities.

'ability to function effectively in a federal system' " (426 U.S. at 852, quoting from *Fry* v. *United States*, 421 U.S. 542, 547 n. 7). The Court was concerned about direct commands issued by the federal government "to the States *qua* States" (426 U.S. at 847) and directly displacing the States' freedom to structure important governmental operations. The Court emphasized the nature of this concern by pointing out that it is activated when the federal government "seeks to regulate directly the activities of States" (*id.* at 841), bringing about the "forced relinquishment of important governmental activities" (*id.* at 847). The Court repeatedly emphasized that the flaw in the congressional plan was compulsion directed against the States.[13]

The Commission's preliminary inquiry involves no compulsion against the "States *qua* States" or anyone else. No state choice has been displaced directly. Perhaps, as appellants contend, private investors will be affected by their knowledge of the Commission's inquiry, but this effect, if it exists, is not unconstitutional.

We see no reason why Congress could not authorize the Commission to investigate state and municipal securities and then issue statements advising the investing public

[13]See, *e.g.*, 426 U.S. at 849 (the statute "directly penalizes the States" and the "congressionally imposed displacement of state decisions may substantially restructure traditional ways in which the local governments have arranged their affairs"); *id.* at 852 (the statute will "prescribe" wages and "directly displace the States' freedom to structure integral operations"); *id.* at 853 (a statute would be permissible if it "displaced no state choices as to how governmental operations should be structured" and did not "force" the States to change their ways); *id.* at 855 (Congress may not exercise its power "so as to force directly upon the States its choices as to how essential decisions regarding the conduct of integral governmental functions are to be made").

whether a particular offering was fairly described and a sound investment. See page 14, *infra*. In so doing, the Commission would be performing a role similar to that of a consumer adviser, and it would exercise no coercive powers. The Constitution would not prohibit the gratuitous distribution of consumer advice by the United States, even though some offerors of securities would be affected. Cf. *Paul* v. *Davis*, 424 U.S. 693. The distribution of advice would not coerce the States in any way, and it would affect them only because private choices might be influenced.

If the United States could issue advice to investors, it necessarily would have the authority to gather essential information from willing suppliers. But that is all the Commission has done or threatened to do here—it has attempted to gather information from willing suppliers. It has not even made or threatened to make any public statement about the results of its inquiry.

In sum, there has been no direct displacement of state choices. Appellants argue that there need be none, but that argument "proves too much, since it implies that every instance in which federal action has a significant *de facto* effect upon the states or their political subdivisions involves an impermissible interference with state sovereignty" (J.S. App. A12). Almost every action by the United States indirectly affects the States. For example, a decision by the United States Treasury to sell additional federal bonds or bills would attract investment funds that might otherwise be available to purchase municipal securities; no one, however, would seriously contend that the sale of federal securities is unconstitutional. Many other federal statutes affect the States: the provision of the Internal Revenue Code making income from municipal securities exempt from federal taxes enhances the attractiveness of those securities, yet the repeal of the

exemption would not be unconstitutional; moreover, as the district court pointed out (J.S. App. A13), appellants' argument would invalidate even those federal plans based on the federal spending power, including the Social Security Act, that are designed to influence state decisions by making particular courses of action especially attractive. These illustrations demonstrate that a federal action is not unconstitutional just because it has an indirect effect on municipal operations.

Finally, even a conclusion that any direct enforcement action against a municipality growing out of a preliminary investigation would be unconstitutional would not be a sufficient foundation for the relief appellants seek. The preliminary inquiry might serve as a forum to gather information that could serve as a basis for recommending legislation. For example, the Commission recently issued a staff report concerning transactions in securities by the City of New York; major portions of this study pertained only to the conduct of underwriters, rating agencies and bond counsel.[14] So long as any legitimate goal could be served by the inquiry, it could not properly be enjoined.

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[14]Securities and Exchange Commission Staff Report on Transactions in Securities of the City of New York, Committee Print of the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance and Urban Affairs, 95th Cong., 1st Sess. (1977).

CONCLUSION

The appeal should be dismissed for want of jurisdiction. If the Court concludes that it has jurisdiction of the appeal, it should affirm the judgment of the district court.

Respectfully submitted.

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